

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF RIVER BLUFFS, INC.	)	
FOR AN ADJUSTMENT OF RATES PURSUANT	)	
TO THE ALTERNATIVE RATE FILING	)	CASE NO. 95-365
PROCEDURE FOR SMALL UTILITIES	)	

O R D E R

On August 23, 1995, River Bluffs, Inc. ("River Bluffs") filed its application for Commission approval of proposed sewer rates. Commission Staff, having performed a limited financial review of River Bluffs' operations, has prepared the attached Staff Report containing Staff's findings and recommendations regarding the proposed rates. All parties should review the report carefully and provide any written comments or requests for a hearing or informal conference no later than 15 days from the date of this Order.

IT IS THEREFORE ORDERED that all parties shall have no more than 15 days from the date of this Order to provide written comments regarding the attached Staff Report or requests for a hearing or informal conference. If no request for a hearing or informal conference is received, this case will be submitted to the Commission for a decision.

Done at Frankfort, Kentucky, this 5th day of December, 1995.

ATTEST:

  
Executive Director

PUBLIC SERVICE COMMISSION

  
For the Commission

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF RIVER	)	
BLUFFS, INC. FOR A RATE	)	
ADJUSTMENT PURSUANT TO THE	)	CASE NO. 95-365
ALTERNATIVE RATE FILING	)	
PROCEDURE FOR SMALL UTILITIES	)	

STAFF REPORT

Prepared By: Mark C. Frost  
Public Utility Financial  
Analyst, Chief  
Water and Sewer Revenue  
Requirements Branch  
Financial Analysis Division

Prepared By: Chris Smith  
Public Utility Rate Analyst  
Communications, Water  
and Sewer Rate Design Branch  
Rates and Research Division

STAFF REPORT  
ON  
RIVER BLUFFS, INC.  
CASE NO. 95-365

On August 23, 1995 River Bluffs, Inc. ("River Bluffs") filed its application seeking to increase its rates pursuant to 807 KAR 5:076, the Alternative Rate Adjustment Procedure for Small Utilities ("ARF"). Because River Bluffs requested and received Commission Staff ("Staff") assistance in preparing its ARF application, Staff performed a limited financial review of River Bluffs' test-period operations for the 1994 calendar year, prior to the filing of the application.

The scope of the review was limited to obtaining information to determine whether the test-period operating revenues and expenses were representative of normal operations. Insignificant or immaterial discrepancies were not pursued and are not addressed herein.

Mark Frost of the Commission's Division of Financial Analysis performed the limited review on June 16 and 22, 1995 and July 26, 1995. Mr. Frost is responsible for the preparation of this Staff Report except for the determination of Operating Revenue, Rate Design, and Attachment D, which were prepared by Chris Smith of the Commission's Division of Rates and Research.

A comparison of River Bluffs' actual and pro forma operations is shown in Attachment A. Based upon Staff's recommendations, River Bluffs' operating statement would appear as set forth in Attachment B.

As shown in Attachment C, River Bluffs determined that its pro forma operations support a revenue requirement of \$93,624, an increase in its revenue from rates of \$33,993. However, as shown in that same attachment, Staff's recommended operations result in a total revenue requirement of \$79,598. Therefore, Staff recommends that River Bluffs be granted an increase to its annual operating revenues from rates of \$17,487. The rates contained in Attachment D will achieve Staff's recommended level of revenue from rates of \$79,438.<sup>1</sup>

The Natural Resources and Environmental Protection Cabinet has directed River Bluffs to make several capital improvements to its treatment system. To fund its capital improvements, River Bluffs obtained a 2-year demand note from the National City Bank with an interest rate of 10.25 percent per annum. River Bluffs' monthly debt payments are based on a 5-year amortization.

Normally Staff includes a dollar-for-dollar coverage of interest expense in its recommended revenue requirement. However, in this instance if the short-term interest is included in the general rate calculation, then the potential exists, in the long run, for River Bluffs to earn in excess of an 88 percent operating ratio. Therefore, Staff is of the opinion that, to negate the


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<sup>1</sup> Recommended Revenue Requirement	\$ 79,598
Less: Non-Operating Income	<u>160</u>
Revenue Requirement from Rates	<u>\$ 79,438</u>

possibility of future overearning, River Bluffs should be granted a monthly surcharge to cover its short-term interest expense.

Staff recommends that River Bluffs' monthly surcharge be in effect for a 60-month period or until the National City Bank loan is retired, whichever is shorter. River Bluffs should be directed to file a schedule of its monthly surcharge collections and loan payments with its Annual Report. The calculation of River Bluffs' monthly surcharge is contained in Attachment D.

Signatures

  
Prepared By: Mark C. Frost  
Public Utility Financial  
Analyst, Chief  
Water and Sewer Revenue  
Requirements Branch  
Financial Analysis Division

  
Prepared By: Chris Smith  
Public Utility Rate Analyst  
Communications, Water and  
Sewer Rate Design Branch  
Rates and Research Division

**ATTACHMENT A  
STAFF REPORT CASE NO. 95-385  
RIVER BLUFFS REQUESTED OPERATIONS**

	1994 Test Year	Adjustments	Projected
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Income:			
User Fees	\$59,632	\$33,992	\$93,624
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Expenses:			
Management Fees	\$4,800	\$600	\$5,400
Rent	3,000	600	3,600
Office Supplies	1,140	0	1,140
Office Equipment Repair	860	(410)	450
Office Equipment Purchase	79	121	200
Electricity - Hayfield Lift Station	1,442	(542)	900
Electricity - Creek View Plant	6,304	896	7,000
Water	1,769	(1,519)	250
Operations	6,618	762	7,380
Pump Repairs	702	0	702
Collection System Repairs	15,426	(13,426)	2,000
Telephone	1,488	0	1,488
Testing	2,520	5,640	8,160
Chemicals	478	1,305	1,783
Supplies	566	(1)	565
Repairs Lift Station & Tanks	2,000	1	2,001
Repairs Electrical Controls	228	0	228
Sludge Hauling	2,070	7,395	9,465
Postage	348	(88)	260
Engineering Services	5,961	(4,561)	1,400
Seminars & Training	828	(430)	398
Memberships	125	385	510
Bank Service Charges	364	(344)	20
Taxes	313	587	900
Casualty Insurance	1,012	(475)	537
Legal	1,024	476	1,500
Accounting	1,498	202	1,700
Subscriptions	413	0	413
Health Insurance less Refunds	7,914	(4,529)	3,385
Charitable Contributions	1,500	(1,500)	0
Loan Repayments - Principal	7,373	1,503	8,876
Interest	1,186	4,042	5,228
New Plant & Equipment	1,366	634	2,000
Permits	555	5	560
Collection Expense - Louisville Water	0	1,893	1,893
PSC Maintenance	96	(6)	90
Federal Taxes	33	0	33
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Total Expenses	\$83,399	(\$984)	\$82,415
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Net Income	(\$23,767)	\$34,976	\$11,209
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**ATTACHMENT B**  
**STAFF REPORT CASE NO. 95-365**  
**STAFF'S RECOMMENDED PRO FORMA OPERATIONS**

	Actual Operations	Pro Forma Adjustments	Foot- Note Ref	Pro Forma Operations
Operating Revenue:				
Residential - Flat Rate	\$59,632	\$2,319	A	\$61,951
Operating Expenses:				
Owner/Manager Fee	\$4,800	(\$1,200)	B	\$3,600
Sludge Hauling	2,070	7,266	C	9,336
Utility Service - Water	1,769	(1,605)	D	164
Fuel & Power	7,746	0		7,746
Chemicals	478	864	E	1,342
Routine Maintenance Fee	6,618	762	F	7,380
Maint. Collection System	15,426	(14,852)	G	574
Maint. Pumping System	702	0		702
Maint. Treatment & Disposal System	2,228	0		2,228
Maint. Other Plant - KPDES Testing	2,520	5,800	H	8,320
Agency Collection Fee	0	1,892	I	1,892
Administrative & General Salaries	0	1,800	J	1,800
Office Supplies & Other Exp.	2,645	(1,810)	K	835
Outside Services	2,521	(1,024)	L	1,497
Insurance	8,927	(6,330)	M	2,597
Miscellaneous General Exp.	12,111	(9,558)	N	2,553
Office Rent	3,000	0		3,000
Depreciation	3,988	5,574	O	9,562
Amortization	0	2,262	P	2,262
Taxes Other Than Income Taxes	255	556	Q	811
Income Taxes	187	(187)	R	0
Total Operating Expenses	\$77,991	(\$9,790)		\$68,201
Net Operating Income	(\$18,359)	\$12,109		(\$6,250)
Other Income:				
Interest Income	160	0		160
Miscellaneous Nonoperating Income	7,988	(7,988)	S	0
Other Deductions:				
Interest Expense	6,315	(1,752)	T	4,563
Net Income	(\$16,526)	\$5,873		(\$10,653)

**A. Operating Revenue Normalization:**

The revenue normalization adjustment reflects River Bluffs' current tariffed rate and its end-of-period customer level.

River Bluffs' Current Tariffed Rate	\$31.10
Multiplied by: End-of-Period Customer Level	166
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Monthly Collections	\$5,162.60
Multiplied by: 12-Months	12
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Normalized Revenue from Rates	\$61,951
Less: Reported Revenue from Rates	59,632
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Staff's Recommended Adjustment	\$2,319
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**B. Owner/Manager Fee:**

River Bluffs reported a test-period owner/manager fee expense of \$4,800. However, River Bluffs actually paid Harold Helm, River Bluffs' President, \$3,000; the remaining \$1,800 was paid to Anne Helms, River Bluffs' Vice President/Treasurer. To support River Bluffs' request to increase Mr. Helm's owner/manager fee to \$3,600, it included a list of Mr. Helm's duties and responsibilities in the application. The listed duties are comparable to the general oversight responsibilities of a water district commissioner. According to KRS 74.020 (6), a water district commissioner shall receive an annual salary of not more than \$3,600. Given the similarity between the two positions, Staff is of the opinion that an owner/manager fee of \$3,600 is reasonable and has adjusted test-period operations to reflect it. Ms. Helm's salary is discussed in the administrative and general salaries adjustment.

Recommended Owner/Manager Fee	\$3,600
Less: Reported Owner/Manager Fee Expense	4,800
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Staff's Recommended Adjustment	(\$1,200)
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**C. Sludge Hauling:**

Because of repairs to the in-flow and infiltration of the sewer, River Bluffs estimated that it will be required to haul 2 loads of sludge per month at a cost of \$778. Upon consulting with Larry Updike of the Commission's Division of Engineering, Staff believes it is reasonable to expect River Bluffs to haul 2 loads of sludge per month on a recurring basis. This adjustment reflects the increased number of loads at the current rate charged by the James Headden Septic Tank Service.

Monthly Sludge Hauling Fee	\$778
Multiplied by: 12 Months	12
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Pro Forma Sludge Hauling	\$9,336
Reported Sludge Hauling Expense	2,070
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Staff's Recommended Adjustment	\$7,266
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**D. Utility Service - Water:**

In the test period, River Bluffs installed a recirculation water pump, which drastically reduced its level of water consumption. An adjustment to reflect the decreased water purchases would meet the rate-making criteria of known and measurable. Therefore, test-period operations have been adjusted to reflect the April 16, 1994 through April 15, 1995 water purchases.

	Service From	Service To	Amount
	16-Apr-94	11-Jun-94	\$14
	11-Jun-94	13-Aug-94	14
	13-Aug-94	22-Oct-94	27
	22-Oct-94	17-Dec-94	30
	17-Dec-94	18-Feb-95	46
	18-Feb-95	15-Apr-95	33
Pro Forma Water Expense			\$164
Less: Reported Water Expense			1,769
Staff's Recommended Adjustment			(\$1,605)

**E. Chemicals:**

The Natural Resources and Environmental Protection Cabinet ("Natural Resources") directed River Bluffs to install a dechlorinator at its treatment plant. River Bluffs estimated the dechlorinator will use 2 cylinders of sulfur dioxide every quarter. Upon consulting with Bob Arnett of the Commission's Division of Engineering, Staff determined that River Bluffs' estimate is reasonable and therefore, chemical expense has been adjusted.

Cost of 2 Cylinders of Sulfur Dioxide	\$216
Multiplied by: 4 Quarters	4
Staff's Recommended Adjustment	\$864

**F. Routine Maintenance Fee:**

The routine maintenance fee paid to Jack Wolford increased on October 1, 1995 from \$550 to \$ 615 per month. Staff is of the opinion that the fee is reasonable and has adjusted test-period operations to reflect the increased fee.

Monthly Routine Maintenance Fee	\$615
Multiplied by: 12 Months	12
Pro Forma Routine Maintenance Fee	\$7,380
Less: Reported Routine Maintenance Fee	6,618
Staff's Recommended Adjustment	\$762

**G. Maint. Collection System**

Upon review of the test-period invoices, Staff noted that the following expenditures are capital in nature. Therefore, they have been removed from test-period operations and depreciated over their estimated useful lives.

Vendor	Description	Amount
Earth Services	System Rehabilitation	(\$11,922)
Earth Services	Smoke Test of System	(2,930)
Staff's Recommended Adjustment		(\$14,852)

**H. Maint. Other Plant - KPDES Testing:**

In 1994, Natural Resources changed River Bluffs' KPDES testing requirement from monthly to weekly. River Bluffs' KPDES testing is performed by Beckmar Laboratory at a fee of \$160 per test. An adjustment to reflect Natural Resources testing requirements meets the rate-making criteria of known and measurable and therefore, KPDES testing expense has been increased.

Testing Fee	\$160
Multiplied by: Required No. of Tests	52
Pro Forma Testing Expense	\$8,320
Less: Reported Testing Expense	2,520
Staff's Recommended Adjustment	\$5,800

**I. Agency Collection Fee:**

River Bluffs' customer billing and collection is performed by the Louisville Water Company at a fee of \$1.90 per customer. Because test-period operating revenue was reported net of the billing and collection fee, the fee was not included as an expense. Since the operating revenues recommended herein reflect the gross collections, test-period operations have been adjusted to reflect the fee.

Collection Fee	\$1.90
Multiplied by: No. of Annual Bills	166 Customers x 6 Billing Periods = 996
Staff's Recommended Adjustment	\$1,892

**J. Administrative & General Salaries:**

In its application River Bluffs listed the duties and responsibilities of its Vice President/Treasurer. After reviewing the list, Staff is of the opinion that the fee of \$150 per month is reasonable and it should be reflected in test-period operations.

Monthly Secretarial Fee	\$150
Multiplied by: 12 Months	12
Staff's Recommended Adjustment	\$1,800

**K. Office Supplies & Other Exp.**

Upon review of the test-period invoices, Staff noted that the following expenditures are capital in nature. Therefore, they have been removed from test-period operations and depreciated over their estimated useful lives.

Vendor	Description	Amount
Hellow Direct	Fax Machine	(\$734)
Hardware	340 MB IDE Drive	(391)
Hardware	1MB SIMM or SIPP Modules	(224)
Entre	2 MB Upgrade Board	(131)
Louisville Tractor	Weed Trimmer	(330)

Staff's Recommended Adjustment	(\$1,810)
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**L. Outside Services:**

Upon review of the test-period invoices, Staff noted that the following expenditure is nonrecurring in nature. Therefore, this expenditure has been removed from test-period operations and amortized over its estimated useful life.

Legal Fees for Civil Action	(\$1,024)
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**M. Insurance:**

During the test period River Bluffs provided health insurance for its owner and his family. Furthermore, deductibles/co-payments were paid by River Bluffs and included in its test-period operations. The deductibles/co-payments are the personal responsibility of Mr. Helm and should not be reported by River Bluffs as an operating expense. Therefore, these costs have been deleted from River Bluffs' test-period operations. Mr. Helm's employment status does not entitle him to have his family insurance paid by River Bluffs and ultimately borne by its customers. The current trend is for companies to provide coverage for full-time employees, but to require the employee to pay family insurance coverage. Because the Vice President/Treasurer worked only 10 hours per month, her position is a part-time position. Consequently, the Vice President/Treasurer is not entitled to insurance coverage. Insurance expense has therefore, been adjusted to reflect River Bluffs providing single health insurance coverage of its owner/manger.

Health Insurance - Single	\$111
Life Insurance - Mr. Helm	4
Administrative Charge	17
Monthly Health Insurance Premium	\$132
Multiplied by: 12 Months	12
Pro Forma Insurance Expense	\$1,584
Reported Insurance Expense	7,914
Staff's Recommended Adjustment	(\$6,330)

**N. Miscellaneous General Exp:**

This Adjustment reflects: (1) River Bluff's owner/manager has several business interests that require the use of a cellular telephone. However, River Bluffs is responsible for 100 percent of the cellular telephone bill. The fee charged for a business line in Oldham County is a reasonable method to allocate the cellular telephone cost to River Bluffs; (2) Non-recurring items have been removed from test-period operations and amortized over their estimated useful lives; and (3) Non-operating costs that should be borne by the stockholder, are being removed.

**1) Cellular Telephone Allocation:**

Tariffed Monthly Business Line Fee	\$48
Multiplied by: 12 Months	12

Allocated Telephone Expense	\$576
Reported Cellular Telephone Cost	1,488

Telephone Adjustment	(912)
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**2) Non-recurring Expenditures:**

H.E. Rudy Engineering	Infiltration Correction	(5,961)
KPDES Permit		(555)

**3) Cost to be Borne by the Stockholder:**

Churchill Downs	Derby & Oaks Tickets	(630)
United Way	Charity	(1,500)

Staff's Recommended Adjustment	(9,558)
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**O. Depreciation:**

This adjustment reflects: (1) Depreciating test-period capital expenditures over their estimated useful lives; and (2) Depreciating post test-period plant improvements.

	Amount	Estimated Useful Lives	Depreciation Expense
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<b>1) Test-Period Capital Expenditures:</b>			
Fax Machine	\$734	5	\$147
340 MB IDE Drive	\$391	5	78
1MB SIMM or SIPP Modules	\$224	5	45
2 MB Upgrade Board	\$131	5	26
Weed Trimmer	\$330	5	66
Earth Sciences - Infiltration	\$14,852	10	1,485
<b>2) Post-Test Period Capital Expenditures:</b>			
Dechlorination Equipment	\$6,938	5	1,388
Electrical Controls & Cabinet	\$500	5	100
Infiltration Repairs	\$9,038	10	904
H. E. Rudy Engineer - 1995	\$2,384	10	238
Computer	\$2,583	5	517
Printer	\$1,559	5	312
Renovation of Lift Station	\$2,682	10	268
Staff's Recommended Adjustment			<hr/> \$5,574 <hr/>

**P. Amortization:**

This adjustment reflects: (1) Amortizing test-period non-recurring expenditures over their estimated useful lives; and (2) Amortizing post test-period non-recurring expenditures.

	Amount	Estimated Useful Lives	Amortization Expense
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1) Test-Period Non-recurring Expenditures:			
H.E. Rudy Engineering	\$5,981	10	598
KPDES Permit	\$1,915	10	192
Legal Fees for Civil Action	\$1,024	3	341
2) Post-Test Period Non-recurring Expenditures:			
H.E. Rudy Engineering - 1995	\$1,502	10	150
Legal Fees - Division of Water 1995	\$1,823	3	608
Appraisal for Loan	\$750	2	375
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Staff's Recommended Adjustment			\$2,262
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**Q. Taxes Other Than Income Taxes:**

River Bluffs failed to report its 1994 property taxes in its test-period operations. This adjustment corrects River Bluffs' error.

1994 Property Taxes	\$556
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**R. Income Taxes:**

This adjustment removes income taxes reported by River Bluffs in the test period.

Income Tax	(\$187)
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**S. Miscellaneous Nonoperating Income:**

The Kentucky Supreme Court has held: "Profit made from the sale of non-depreciable land no longer used to serve customers is not an ingredient to be considered in fixing rates. The customers had no interest in the profit realized on the sale - it belonged to the stockholder." Therefore, the gain on the sale of land has been removed from River Bluffs' test-period operations.

Gain on Sale of Land	(\$7,988)
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**.T. Interest Expense:**

This adjustment reflects the National City Bank Loan River Bluffs will incur to pay for the test-period and post test-period plant improvements.

Amount of Loan	\$48,000
Annual Interest Rate	10.25%
Term - Years	5
Monthly Payment	\$1,026

Payment No.	Monthly Payment	Monthly Interest	Monthly Principal	Principal Balance
Beg. Balance				\$48,000
1	\$1,026	\$410	\$616	47,384
2	1,026	405	621	46,763
3	1,026	399	627	46,136
4	1,026	394	632	45,504
5	1,026	389	637	44,867
6	1,026	383	643	44,224
7	1,026	378	648	43,576
8	1,026	372	654	42,922
9	1,026	367	659	42,263
10	1,026	361	665	41,598
11	1,026	355	671	40,927
12	1,026	350	676	40,251
Totals	\$12,312	\$4,563	\$7,749	\$40,251
Reported Interest Expense		6,315		
Staff's Recommended Adjustment		(\$1,752)		

**ATTACHMENT C  
STAFF REPORT CASE NO. 95-385  
REVENUE REQUIREMENT COMPARISON**

**River Bluffs' Revenue Requirement:**

Adjusted Operating Expenses	\$82,415
Divided by: Requested Operating Ratio	88%
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Requested Revenue Increase	\$93,653
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**Staffs' Recommended Revenue Requirement**

Adjusted Operating Expenses	\$68,201
Divided by: Recommended Operating Ratio	88%
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Subtotal	\$77,501
Less: Adjusted Operating Expenses	68,201
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Net Income After Income Taxes	\$9,300
Multiplied by: Income Tax Gross-up Factor	1.2284902
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Net Income Before Income Taxes & Interest Expense	\$11,397
Add: Adjusted Operating Expenses	68,201
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Recommended Revenue Requirement	\$79,598
Less: Normalized Operating Revenue	61,951
Non-Operating Revenue	160
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Recommended Revenue Increase	\$17,487
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ATTACHMENT D  
STAFF REPORT CASE NO. 95-365  
CALCULATION OF MONTHLY RATE & SURCHARGE

**Staff's Recommended Monthly Rate:**

Recommended Revenue Requirement	\$79,598
Less: Non-Operating Income	160

Revenue Requirement from Rates	\$79,438
Divided by: 12 Months	12

Monthly Revenue from Rates	\$6,619.83
Divided by: End-of-period Customer Level	168

Staff's Recommended Monthly Rates	\$39.88
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**Staff's Recommended Monthly Surcharge:**

Annual Interest Expense	\$4,563
Divided by: 12 Months	12

Monthly Surcharge Collections	\$380.25
Divided by: End-of-period Customer Level	168

Staff's Recommended Monthly Surcharge	\$2.29
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